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BRIEF FOR PETITIONERS.

Supreme Court of the United States

OCTOBER TERM, 1929

NO. 311

WALTER A. MAY, HERBERT L. MAY, EDWIN C. MAY, ET AL., Executors of the Last Will and Testament of Pauline May, Deceased, Petitioners, Appellants,

v.

D. B. HEINER, Collector of Internal Revenue for 23rd District of Pennsylvania.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

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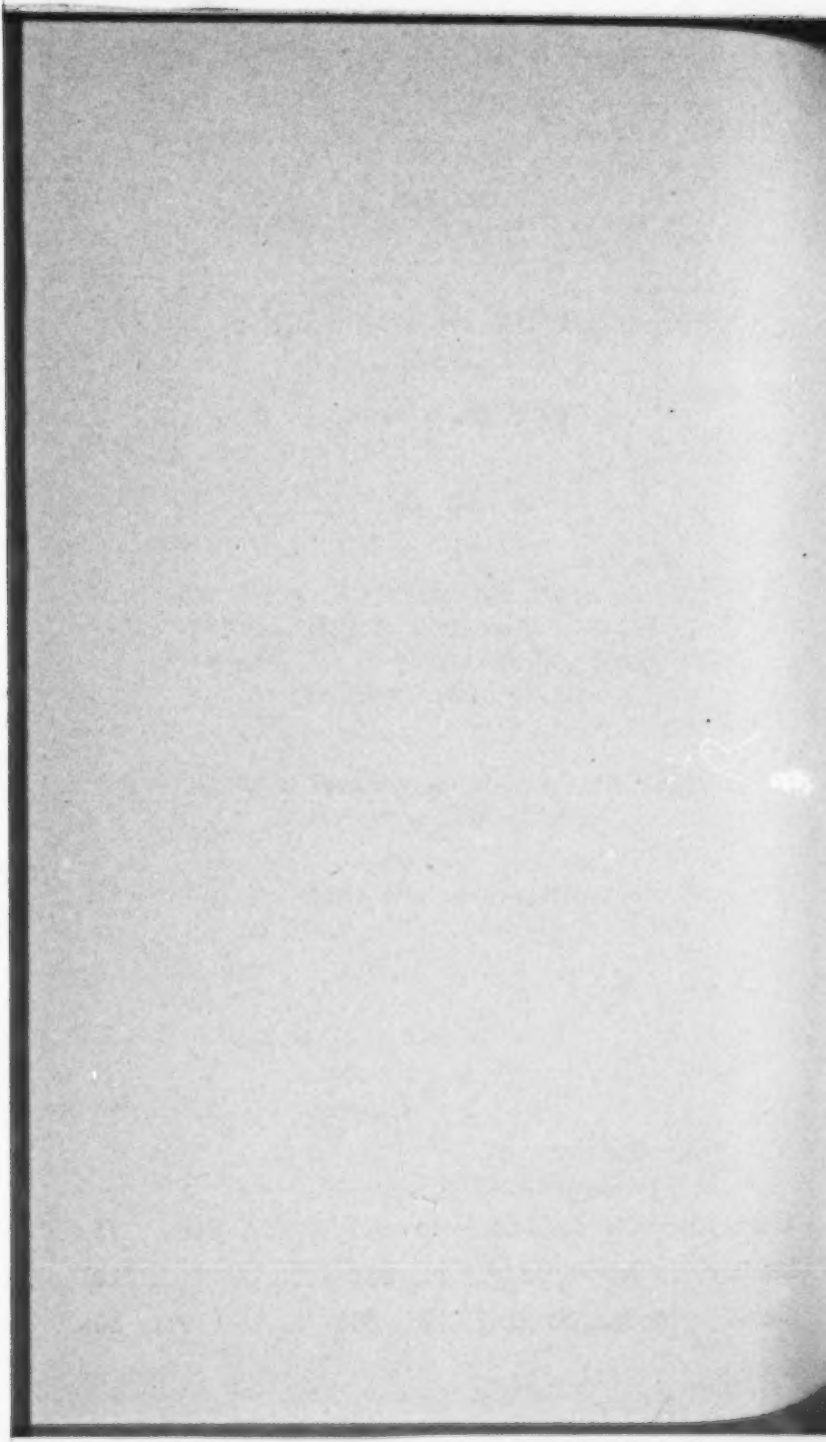

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BRIEF FOR PETITIONERS.

Opinions Below.

The opinion of the District Court (R. 32) is reported at 25 F. (2d) 1004. The opinion of the Circuit Court of Appeals (R. 41) is reported at 32 F. (2d) 1017.

Jurisdiction.

The judgment of the Circuit Court of Appeals (R. 41) was entered on January 9, 1929. A petition for rehearing (R. 42) was filed on January 18th, 1929. The order denying the petition for rehearing (R. 42) was entered June 24, 1929. Petition for certiorari was filed August 8th, 1929, and granted October 21, 1929, (R. 43) under the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229, section 1, 43 Stat. 938. The respon-

dent filed a memorandum in which it stated that it did not oppose the petition for certiorari.

This was an action at law brought by petitioners against the respondent in the District Court (R. 2) to recover a sum assessed against them under the Revenue Act of 1918, for additional Federal Estate Tax. To petitioners' statement of claim (R. 2), the respondent filed a motion (R. 31) to strike the statement of claim from the record. The District Court, in an opinion (R. 32), and order (R. 38), entered judgment in favor of respondent on the question of law raised by the motion.

The Questions Presented.

The case presents the question, first, whether the corpus of an irrevocable trust created by the decedent in 1917, not in contemplation of death, which provided for the payment of the income thereof to decedent's husband, during his lifetime, and after his decease, to decedent, during her lifetime, and for the distribution, after their decease, of all of the property in said trust among decedent's children, decedent's husband having survived her, is property transferred, or with respect to which a trust was created, intended to take effect in possession or enjoyment at or after her death, under the provisions of the Revenue Act of 1918.

If that question be answered in the affirmative, it presents the next question, whether the Revenue Act of 1918, so construed, is constitutional.

The Statute.

The Revenue Act of 1918, c. 18, 40 Stat. 1096, 1097, provides as follows:

> "Sec. 402. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property * * * (c) to the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death (whether such transfer or trust is made or created before or after the passage of this Act) * * *."

Statement.

This is an action at law for the recovery of $5,763.82 with interest, estate taxes, collected by duress by the respondent.

Petitioners' testatrix died in the City of Pittsburgh, Pennsylvania on the 25th day of March, 1920. Her executors filed an estate tax return in which they disclosed a net estate for taxes of $148,461.53, on which there was a tax due of $2,469.23. The Commissioner of Internal Revenue made a demand for the payment of additional taxes amounting to $5,557.76, based, in the main, upon the inclusion by the Commissioner of certain property concerning which the testatrix made a trust, for the alleged reason that the trust was in contemplation of or intended to take effect in possession or enjoyment at or after the testatrix's death.

The testatrix made two declarations of trust, one dated May 17, 1917 (R. 12), in which it was recited that whereas the decedent holds certain property con-

sisting of bonds, stocks, notes and money in bank, of a market value of about $150,000, which were purchased largely with the funds of her husband, Barney May, and she desires to place them in trust, as thereinafter mentioned, wherefore she transfers and assigns said property to B. May (who was her husband), W. A. May, H. L. May, E. C. May and L. J. Affelder, as trustees, the said trustees to pay to B. May the net income for life, and after his death, to Pauline May for life, if she survive him; and after the death of both of them, the said property is to be divided equally between her sons and daughter, W. A. May, Estelle M. Affelder, H. L. May and E. C. May; all of which will appear in a formal instrument of trust to be drawn up, listing the said property, and to be duly executed by her.

The other was an agreement dated October 1st, 1917, (R. 13), between the decedent of the one part, and said trustees, wherein she transferred and assigned to said trustees the property therein mentioned, in trust, to collect the income, etc., and to pay the net dividends "to Barney May during his lifetime, and after his decease, to Pauline May during her lifetime, and after her decease, all of the property in said trust * * * shall * * * be distributed equally among" her above named children.

Barney May survived his wife, and the estate tax return was made by him and the other executors named in her will.

Petitioners paid to respondent the sum of $33.34 additional tax due by reason of certain minor changes made in valuations, and made a claim for abatement of the balance of $5,524.42 of said additional tax assessment (R. 24.) The said claim for abatement was rejected, and petitioners, upon demand of respondent, paid to respondent the sum of $5,524.42, together

with interest at the rate of 10% per annum from April 5th, 1923, or a total of $5,763.82.

After petitioners filed a claim for refund (R. 27), which was rejected, they brought suit to recover the last mentioned sum with interest.

The respondent filed a motion to strike petitioners' statement of claim from the record, for the reason that the trust created by the decedent is properly included in the decedent's gross estate, under the provisions of Sec. 402 (c) of the Revenue Act of 1918 (R. 31).

The District Court (R. 32), held that the property covered by the trust constituted property with respect to which the decedent made transfers intended to take effect in possession or enjoyment at or after death, and directed judgment to be entered in favor of respondent on the question of law raised by the pleadings (25 F. (2d) 1004).

Petitioners appealed from said order to the Circuit Court of Appeals, which, in a per curiam, (R. 41), affirmed "on the opinion of the court below with the observation that this case is distinguished from *Nichols v. Coolidge,* 274 U. S. 531, on the facts." (32 F. (2d) 1017).

A petition for rehearing was filed for the reason that the question involved in this case was decided by this Court in the case of *Reinecke, Collector, v. Northern Trust Company,* 278 U. S. 339, favorable to petitioner's contention, a week earlier, and that the respondent had stated in its brief that the same issue that was involved in the instant case was presented in the said Reinecke case, in the following language: "The attention of the Court is called to the fact that the issue presented by the instant case will probably be settled by the United States Supreme Court in

Reinecke, Collector, v. The Northern Trust Co., No. 90 (24 Fed. (2d) 91)."

The petition for rehearing was refused (R. 42).

Specifications of Error to Be Urged.

The petitioners contend that the Circuit Court of Appeals, Third Circuit, erred:

1. In affirming the judgment of the District Court of the United States for the Western District of Pennsylvania.

2. In holding that the corpus of the trust constituted property with respect to which the decedent made a transfer intended to take effect in possession or enjoyment at or after her death, and should therefore be included in the gross estate of the decedent, under the provisions of the Revenue Act of 1918.

3. In holding that if the Revenue Act of 1918, according to a correct construction, purports to authorize the tax herein imposed, it is constitutional.

Summary of Argument.

The property forming the corpus of the trust in this case is not property transferred, or with respect to which a trust was created, in contemplation of or intended to take effect in possession or enjoyment at or after the grantor's death, within the meaning of section 402 (c) of the Revenue Act of 1918.

If the said act, properly construed, would require the inclusion of the corpus of said trust in the gross estate of the grantor, it is unconstitutional.

Argument.

I.

THE TRANSFER IN THIS CASE WAS EFFECTIVE TO PASS THE TITLE TO THE PROPERTY AND THE ECONOMIC BENEFITS TO BE DERIVED THEREFROM IMMEDIATELY WHEN IT WAS MADE, ON OCTOBER 1ST, 1917.

There was no power reserved to revoke the transfer or trust. The economic interest was divided, of course. During the lifetime of the husband of the settlor, the income was payable to him. If he died before she did, the income went to her, during her lifetime. The remainder was transferred absolutely to the children.

The language of the statute is as follows:

> "Sec. 402. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property. * * * (c) to the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death (whether such transfer or trust is made or created before or after the passage of this Act) * * *."
>
> *Revenue Act of 1918* (February 24, 1919, 40 Stat. at L. 1096, 1097, Chap. 18).

The only interest which decedent had in the property at the time of her death was her contingent life estate. Everything else she had effectually transferred. She could not, if she changed her mind, retake what she had given to her husband, a life estate in the

income, and what she had given to her children, the remainder after the death of her husband and herself.

> "What this law taxes is not the interest to which the legatees and devisees succeed on death, but the interest which ceased by reason of the death."
>
> *Y. M. C. A. v. Davis*, 264 U. S. 47, at p. 50.

The interest which ceased by reason of Mrs. May's death was her contingent interest.

If neither the value of the life estates, nor that of the remainders, were required to be included in the gross estate in the Reinecke case (278 U. S. 339), notwithstanding the fact that the remainders were intended to take effect in possession or enjoyment at or after settlor's death, the value of the life estate given here to Barney May, settlor's husband, and the value of the remainder given to her children, should not be included in the gross estate. The circumstance that in this case there was the possibility of a life estate in favor of settlor intervening does not detract from the finality and irrevocability of the estates given to others. In the Reinecke case, the economic benefit was divided into two parts or interests. Here it *might* have been divided into three parts or interests, and only one of these interests could cease on Mrs. May's death.

The government erroneously contended in the Reinecke case, as to the five trusts, that even without the reserved powers to manage and modify the trusts, the transfers of the *remainder* interests were all subject to the tax because, within the language of sec. 402, they were intended to take effect in possession or enjoyment at or after his death.

In denying this contention, the Court said (pp. 347, 347):

> "One may freely give his property to another by absolute gift without subjecting himself or his estate to a tax, but we are asked to say that this statute means that he may not make a gift *inter vivos*, equally absolute and complete, without subjecting it to a tax, if the gift takes the form of a life estate in one, with remainder over to another, at or after the donor's death. It would require plain and compelling language to justify so incongruous a result, and we think it is wanting in the present statute."

In principle, there is no difference between the gift of a life estate to A, with remainder to B, and a gift of a life estate to A, a life estate to Z, if the latter survives A, and the remainder to B.

All that can be taxed is the value of that which the settlor did not give away, but which he retained for himself, and which passed from him to some one else upon his death. The language of this statute leans more in the direction of such a conclusion than it does to the contention of the government. But if there is any doubt about it, the doubt should be resolved in the taxpayer's favor: *Gould v. Gould*, 245 U. S. 151.

This Court has not decided, so far as we have been able to discover, the precise question whether a reservation by the settlor of the possession and enjoyment of the income during his life in a trust or transfer created after the passage of the estate tax of 1916 authorizes the imposition of a tax on the corpus of the trust. As we read those opinions of this Court which may be said to shed a light on the question, we find

that they lay down the principle that a tax attaches only in those cases where there is a shifting of the economic use and benefit of property upon the death of settlor, and that *the tax is measured by the value of the economic benefits which pass from the settlor to his successor by the settlor's death.*

There is nothing in the cases of *Chase National Bank v. U. S.*, 278 U. S. 327, or in the Reinecke case, against our position.

In the first case, the insured had full power at all times during his lifetime to dispose of the entire economic benefits or enjoyment in the life insurance policies.

In the Reinecke case, as to the two trusts, the corpus of which this Court held was taxable, the settlor reserved the right to revoke them, and upon the exercise of this right, the trustee was required to return the corpus of the trust to him. He was, therefore, during his lifetime, in the same position as if he were making gifts from time to time of the income, and without obligation to continue them. As we understand the opinion, whatever a person gives away, not in contemplation of death, is free from taxation. But it must be a real gift, without strings attached to it. The extent of the gift, the share of the economic benefit or interest given, is immaterial, providing it is a gift, an irrevocable gift, from the moment of its making.

In *Carnill v. McCaughn*, 30 F. (2d) 696, the facts as stated by the Court in its opinion (p. 697) were that the decedent made a transfer of property to a trustee, reserving to himself the income from the property during his life, the remainder going at his death to named beneficiaries. The interests of the latter were vested

and absolute, and there was no power of revocation or control over the gift retained by the donor. The Court held that there is to be excluded from the taxation:

> "transfers by way of gift *of the remainder* after a life estate reserved, when the gift is not in contemplation of death, is absolute, and the decedent up to the time of his death had no power of control over it, or to direct the course of distribution of the property by his action or non-action." (Italics ours). (p. 699).

In the case of *Nichols v. Bradley*, 27 F. (2d) 47, the Circuit Court affirmed the judgment of the District Court in holding the corpus of a trust not taxable under the Revenue Act of 1918. The trust provided that the income was to be paid to the daughters of the grantor and their issue; if the grantor did not survive the daughters and their issue, the trust was to be continued until 20 years after the death of the last surviving daughter, when the corpus was to be distributed among the issue of the daughters. In case of the death of all three daughters without issue, during the lifetime of the grantor, all of the income was to be paid to her, during her lifetime.

The Court said (page 48):

> "It is the contention of the government, that Mrs. Bradley, upon the making of the declaration of trust, did not part with the possession or enjoyment of this one-half interest in the property contributed by her, and of which the daughters and their issue were to have the income; that she retained a reversionary interest, that was not to pass until her death, and that in fact did not pass until her death. But we think that, upon making

the trust deed, Mrs. Bradley parted with the possession and enjoyment of this half of the property contributed by her to the trust, and that she was to have no reversionary interest in this half unless the daughters and their issue failed to survive her, or (what is the same thing) unless she survived the daughters and their issue, which she did not do. Having died first, no reversionary interest ever arose in her favor. Her death did not pass the right to the possession and enjoyment of the half of the property and income here in question from her to the daughters and their issue. That right passed to them at once by the declaration of trust, subject to defeasance in case they failed to survive Mrs. Bradley. Her death, however, before that of her daughters, foreclosed the possibility of a reversionary interest arising in her favor. In other words, her death did not affect the transfer of the possession and enjoyment of the property and income to the daughters from and after that time, but, having occurred during the lifetime of the daughters, it foreclosed the possibility of her acquiring a reversionary interest in this half of the property."

From the opinion of the District Court, in the same case, *Bradley v. Nichols,* 13 F. (2d) 857, at page 858:

"The present case goes much beyond *Coolidge v. Nichols,* (D. C.) 4 F. (2d) 112, and *Safe Deposit Co. v. Tait,* (D. C.) 295 F. 429, which dealt with trusts in which the donors reserved life estates, and in which it was held that the transaction considered as a whole amounted to a transfer of the property to take effect on the donor's death. *Shukert v. Allen, Collector,* 6 F. (2d) 551 (C. C. A.

8th), supports the government's contention that the language of the statute refers to the time when the final possible *cestui* will get the benefit of the trust. On the other hand, in *Dexter v. Treasurer and Receiver General,* 243 Mass. 523, 137 N. E. 877, the Supreme Judicial Court of Massachusetts, construing a state statute, the language of which upon this point is practically identical with that of the federal statute under discussion, reached a very different conclusion, and held that what was meant by 'taking effect in possession or enjoyment' was the definite determination of interests, whether legal or equitable, and that, if such interests are established during the donor's life, and are in no way contingent upon his death, 'the beneficial interest in the enjoyment of the proceeds of the trust passed at the time of its execution. * * * The possession and enjoyment vested in the beneficiaries when the trust deed was delivered to the trustees. The deed passed the property from the donor, and gave to the beneficiaries at that time the beneficial interest in it, and their enjoyment and possession of it was not contingent on the death of the donor.' Carroll, J., 243 Mass. 526, 137 N. E. 879. This seems to me a more reasonable view of the language and scope of such a statute as I am dealing with than that taken in *Shukert v. Allen, supra.*"

In the case of *Amalie Hirsh et al., executors,* of *Morris M. Hirsh v. the United States,* decided by the Court of Claims on December 2, 1929, No. E-284, the decedent, on November 1, 1919, transferred to each of four of his children securities to the value of $50,000.00 under the terms of agreements entered into with them, separately, in which the child agreed to pay to the

wife of the grantor the sum of $2,000 per annum during her life, and thereafter to the grantor during his life. The Court held that the property transferred was not to be included in the gross estate of the decedent, under sec. 402 (c) of the Revenue Act of 1918.

The government argued below that it must be assumed from the record that Pauline May survived her husband because the Commissioner failed to deduct the value of Barney May's life estate, and cited *United States v. Rindskopf,* 105 U. S. 418. The government, in all fairness, should not attempt by casuistry to establish that to be a fact which it knows is not a fact, in order to gain some advantage over the taxpayer. It has available its own records in the matter of the estate tax of Barney May, which show that Barney May survived his wife. Besides, there is a letter of the Treasury Department attached to the amended statement of claim, record, page 18, which is addressed to Barney May, et al., Executors, Estate of Pauline May. This shows that the estate tax return in the Pauline May Estate was made by Barney May, and the others, as executors. The will shows that the Barney May who was named as an executor was decedent's husband, and we all know that letters testamentary are not granted to a dead person. The estate tax return referred to in the statement of claim, paragraph 3, record, page 3, shows that Barney May was living and making the return. In order not to encumber the record, we did not attach to the statement of claim a copy of the entire return, but attached only the schedules that were relevant and material to the issue. The case of *U. S. v. Rindskopf,* 105 U. S. 418, cited by the government, cannot be tortured into an authority for the false assumption that Barney May died before his wife, in view of the circumstances above set forth.

II.

IF THE REVENUE ACT OF 1918, ACCORDING TO A CORRECT CONSTRUCTION, PURPORTS TO AUTHORIZE THE TAX HERE IMPOSED, IT IS UNCONSTITUTIONAL.

In *Nichols v. Coolidge*, 274 U. S. 531, at pages 542 and 543, this Court said:

> "We must conclude that Sec. 402 (c) of the statute here under consideration, in so far as it requires that there shall be included in the gross estate the value of property transferred by a decedent prior to its passage merely because the conveyance was intended to take effect in possession or enjoyment at or after his death, is arbitrary, capricious and amounts to confiscation. Whether or how far the challenged provision is valid in respect of transfers made subsequent to the enactment, we need not now consider."

The defendant's contention that notwithstanding the above, if a transfer was made after the Act of Sept. 8, 1916 (39 Stat. 756), the prior estate tax law, the corpus of such a trust must be included in the gross estate, notwithstanding that the transfer was made after the passage of the Revenue Act of 1918, under which it is sought to tax the corpus, has been rejected in the following cases:

Dugan, Executor, v. Commissioner, 8 B. T. A. 482;

Alsop, Executor, v. Commissioner, 7 B. T. A 848;

Northwestern Trust Co., Executor, v. Commissioner, 9 B. T. A. 96.

In the Dugan case, (*supra*), on December 31, 1919, the decedent and her two brothers and her sister, each

owning one-fourth of the common stock of a coal mining company, transferred their respective shares of stock to trustees to hold under a declaration of trust, whereby the trustees were to pay the income to the creators of the trust, with rights over to the survivors upon the death of any beneficiary. The decedent died on May 18, 1923. The Board held that the transfer there involved is of the character of that referred to by this Court in Nichols v. Coolidge (*supra*), and that the value of the interest of the decedent in the trust estate should not be included in the gross estate for the purpose of estate tax.

In the Alsop case (*supra*), the decedent, in 1917, created a trust, the income of which, except a small part which was reserved to himself, was payable to a divorced wife, the corpus, at the death of the latter, to be paid to the grantor for life; otherwise to his sons. Held that since the trust was created prior to the enactment of the Revenue Act of 1921, the corpus is not subject to the estate tax.

In the Northern Trust Company case (*supra*), the decedent made, in 1917, a deed of trust of certain real estate, under which the entire net income was to be paid to the grantor for life, and after her death it was to be distributed among her children. In 1919, she made another deed of trust, transferring shares of stock, and provided that during the lifetime of the grantor, the entire net income should be accumulated and added to the principal, and form a permanent portion of such principal, provided that such accumulations should not continue for more than 21 years, and in case the grantor should still be living at the end of 21 years, then thereafter the income should be distributed in the same way that it would be distributed

in case she were not living; and that after the death of the grantor the entire net income from the trust estate should be paid over and distributed to her children. In 1921, she made another deed of trust conveying certain real estate for the uses and purposes set forth in the deed of trust of 1919. It was held that the property transferred by these trusts should be excluded from the gross estate.

The Revenue Act of 1916 has been repealed. To all intents and purposes it is the same as though that statute had never existed. The government cannot avail itself of that act for any purpose save that specified in the statute which repealed it, the Revenue Act of 1918, viz: "the assessment and collection of all estate taxes, and the imposition and collection of all penalties and forfeitures, which have accrued" under the Act of 1916, and, manifestly, no tax accrued against this estate under that act.

The cases of *Bear Lake etc Co. v. Garland,* 164 U. S. 1; *Lamb v. Powder etc. Co.,* 132 Fed. 434, and *Great Northern Ry. Co. v. U. S.,* 155 Fed. 945, cited by the government below on this proposition, presented entirely different situations, and have no bearing on this case.

The government stated in the court below that it did not contend that the transfer in this case was made in contemplation of death. The making of trusts was a common occurrence years before there were any estate taxes. They had a legitimate purpose, quite aside from a desire to avoid estate taxes. There can be no presumption that an improper or unethical motive was at the bottom of this trust.

The language of this Court in the case of Nichols v. Coolidge (*supra*) applies with equal force to the case at bar.

CONCLUSION.

The judgment of the Circuit Court of Appeals should be reversed.

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December, 1929.